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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000263

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E.O. 12958: DECL: 03/16/2018
TAGS: PGOV PREL AJ ENRG
SUBJECT: AZERBAIJAN: TGI SAYS IT IS MOST VIABLE PROJECT FOR
SHAH DENIZ GAS

Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,d)

¶1. (U) This is an action request; see para 12.

¶2. (C) SUMMARY. A representative of the Italian Energy Company Edison argued that of the three pipeline projects vying for volumes of Shah Deniz Phase Two (SD2) gas, the Turkey-Greece-Italy (TGI) project is the most commercially viable. Given the expected output of SD2, only one pipeline project could be sanctioned, in his view, and he expressed concern that perceived USG and EU support for the Nabucco project over TGI could prevent TGI from becoming a realty. He asked for a clarification of the USG stance toward these two pipeline projects. Embassy welcomes guidance onour current position regarding the three pipelines vying for SD 2 gas, i.e.
Nabucco, TGI and the Trans-Adriatic Pipeline (TAP). END SUMMARY.

¶3. (C) On March 12 Energy Officer met with Edison SPA Development Department Hydrocarbons Business Development Project Leader Elio Ruggeri, who had been invited to Baku by the Shah Deniz Consortium to pitch the benefits of his TGI pipeline project.

FALTERING USG TGI SUPPORT?

¶4. (C) Ruggeri said he had met March 11 with SOCAR Marketing Vice-President Elshad Nasirov. Nasirov told him SOCAR sensed lessened USG support for TGI relative to Nabucco since the signing of the March 2007 U.S.-Azerbaijan MOU that stipulated "unconditional USG support for only TGI." (Comment: Nasirov,s interpretation of the MOU is incorrect. The relevant part of this MOU listed one area of bilateral cooperation as "exploring the means to increase the production of Azerbaijan,s natural gas and oil resources by working with relevant governments and investors to ensure the delivery of natural gas and oil via pipeline projects to Southern and Central Europe, including the Turkey-Greece-Italy, potentially Nabucco and other pipelines on the basis of commercial viability.")

¶5. (C) Thanking the USG for past support of TGI, Ruggeri asked what the cuQent USG position was relative to the three pipeline projects vying for SD2 gas. Energy Officer said that the USG realized that "governments don't build pipelines, companies do," and that ultimately the GOAJ and SD Consortium partners would decide where to sell SD2 gas based on commercial considerations tempered by geopolitical ones. He said that the QG supported TGI and Nabucco as part of a

range of possibly commercially viable projects supporting energy diversification, adding that he would query Washington to see if there had been any policy change since the signing of the bilateral Energy MOU.

NETBACK ALTERNATIVE

¶6. (C) Concerning gas transit through Turkey, Nasirov told Ruggeri that the GOAJ and SOCAR were unable to negotiate with the GOT directly to step back from its 15 percent netback scheme, and looked to the EU and Edison (inter alia) to do so. Nasirov said that instead of the arrangement envisioned by the TGI IGA whereby Edison and/or DEPA would buy an amount of Azerbaijani gas at the Georgian-Turkish border and sell 15 percent of it to Botas, he suggested that Edison/DEPA pitch Botas the idea of Azerbaijan selling the equivalent amount directly to Botas. Ruggeri had told Nasirov that he would suggest this idea to the GOT, adding that Edison had no desire to back the GOT 15 percent netback idea. He said the motivation behind the 15 percent netback idea, originally Deputy Energy Minister Sami Demirbilik,s, was to avoid a situation where the GOT was buying gas at a higher price from Azerbaijan than the price offered European consumers downstream of Turkey. Edison and DEPA was willing to buy SD2 gas at either the Turkey-Georgian border, or the Greek one.

SHAH DENIZ BEAUTY CONTEST

¶7. (C) Ruggeri said earlier that day he had given a presentation to the Shah Deniz Consortium members on why they should support the TGI project. Every SD Consortium member except Neftiran Intertrade Company - NICO - was represented.

He said Nabucco and TAP would be makig (separate) similar presentations in the comingweeks. Edison claimed that:

- of the three, TG was the most advanced project. It had secured ransit rights in all the key countries, and had received European Commission exemption for third pary access rules for Poseidon (i.e. the part of th pipeline between Greece and Italy).

- unlike Nabucco and TAP, TGI timelines mesh well with that of SD2. SD2 is scheduled to be producing by late 2013, but neither Nabucco nor TAP will be completed by then. TGI can slow its project down in order to meet SD2 timelines; the other two won,t be able to speed up. SD Consortium members cannot afford to wait for a pipeline to move their product west, since the SD Consortium PSA expires in 2031, and every extra day it can move and sell their gas means more profit for the Consortium.

SD2 = 8 to 9 BCM/A FOR EUROPE

¶8. (C) Ruggeri said that the SD Consortium told him that SD2 would have approximately 13 bcm/a production beginning late ¶2013. Ruggeri said approximately two of this would probably go to Georgian and Azerbaijani markets, leaving 11 bcm/a available at the Georgian-Turkey border. It was clear that Turkey would also be seeking at a minimum two to three bcm/a from SD2, leaving at most eight to nine bcm/a of SD2 gas available for Europe. (Comment: SD2 Consortium members have told EnergyOff that they expected Turkey to take anywhere from two to six bcm/a of SD2, leaving 5 to 9 bcm/a available for export past Turkey to Europe.)

¶9. (C) Given the fact that there would only be approximately 8-9 bcm/a of SD2 available for Europe, Ruggeri said that TGI was the only project that could be fully sanctioned with this amount. Edison could sell 8 bcm/a easily in the Italian market for power generation, and DEPA could sell 1.5 to 2 bcm/a in Greece. He warned that if due to primarily

non-commercial considerations the SD2 Consortium decides to sell its gas to Nabucco instead of TGI, not only would this amount not be able to sanction Nabucco but its lack would doom TGI, resulting in the sanctioning of neither project.

¶10. (C) Ruggeri said the SD Consortium would have a Special Purpose Vehicle (SPV) in place by the end of April or early May to market SD2 gas. This SPV would be for SD2 marketing what the AGSC (Azerbaijan Gas Supply Company, led by Statoil) had been for SD1 gas. Based on informal comments to him by SD2 Consortium members, he was concerned about how the SD2 Consortium was going to market its gas. He said the Consortium would seek proposals from individual companies (i.e. OMV, EGL, Edison, DEPA) as to how much volume each would buy, at what price and at what location, (for example, Edison bidding to buy 8 bcm/a at USD 300 at the Georgian-Turkey border). However, by seeking bids from individual companies vice consolidated bids from the different pipeline projects, Ruggeri feared that it would make an ultimate decision even harder, since the highest-priced bids could come from competing pipeline projects, but that ultimately SD2 gas was only enough to sanction one project.

¶11. (C) More generally, Ruggeri was concerned that due to EU and USG support of Nabucco over TGI, the GOAJ would choose Nabucco, although based on commercial considerations alone he felt that it was clear TGI was the most viable and desirable project. Nabucco was not a viable project in the 2013 time frame, because it would not be able to find enough gas to sanction construction. It might be viable at a later time, but for now he said USG and EU focus on furthering it would not only be bootless, it would also be counter-productive to the larger strategic goal of getting Caspian gas to Europe.

¶12. (C) COMMENT AND ACTION REQUEST: We note SOCAR's interpretation of the current USG position on projects now competing for Azerbaijan's gas, based on recent public comments, as preferring Nabucco, and Ruggeri's claim that there is only going to be enough SD2 gas to sanction one pipeline, and USG support for both TGI and Nabucco could hinder the prospects for success of both. The perceived disconnect between our current highly public USG support of Nabucco and the language contained in our U.S.-Azerbaijan bilateral MOU has left at least some of our key partners

confused about our intent. We welcome Department's guidance on the USG position regarding the three pipelines currently vying for SD 2 gas, i.e. Nabucco, TGI and the Trans-Adriatic Pipeline (TAP); unless otherwise instructed we will continue to take the position outlined in para 5.
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